JM FINANCIAL

India Strategy

1QFY21: Continued focus on cost reduction

Suhas Harinarayanan
suhas.hari@jmfl.com | Tel: (91 22) 66303037
Ankit Bihani
ankit.bihani@jmfl.com | Tel.: (91 22) 62241881
Arshad Perwez
arshad.perwez@jmfl.com | Tel: (91 22) 66303080
Aishwarya Sonker
aishwarya.sonker@jmfl.com | Tel: (91 22) 66303372

For the 81 companies under our coverage that have reported earnings, PAT declined 26% YoY in-line with our expectations,with only few sectors namely, chemicals, financials (banks), pharma and IT (ex TCS) still managing to record an increase in PAT during the quarter. Among sectors, cement, chemicals, metals, pharma, mid-caps incl. building materials surprised positively on PAT performance as compared to our expectations, while financials (due to Covid-19 led provisioning), infrastructure, industrials reported PAT lower than expectations.

Impacted by lower economic activity on account of Covid-19 led lock-down, overall sales declined by 30% YoY in-line with our muted expectations and sales de-growth was reported across sectors barring pharma, IT and financials. Airlines, real-estate, auto, energy, industrials reported sharpest YoY sales declines among sectors. As we have been highlighting in our earlier notes, cost containment and deferral of spending has been the broad theme in 1QFY21 and as a result, EBITDA de-growth was limited to 11% YoY, and was better than JMFe of -14% YoY. Cement, chemicals, IT, oil & gas and pharma in particular reported expansion of EBITDA margins during the quarter.

The beats-to-missed (BTM) ratio has improved sequentially and at 1.03x in 1QFY21 was up from 0.75x of the past two quarters and 0.9x over the past six quarters.

The focus of the quarter was clearly on cost and cash preservation and is likely to be a key theme for the rest of FY21 as well. Of the 81 companies, we find 1/3rd of the companies have reduced salaries/deferred bonus and 1/6th have reduced manpower (Exhibit 9). Lack of demand visibility is driving 1/3rd of companies to reduce/defer their capex and almost 1/5th of companies have re-negotiated their rental leases. Barring staples & chemicals which have seen near normalisation of operations, most of the companies across sectors are focused on aggressive cost reduction initiatives over the next few quarters (Exhibit 10).

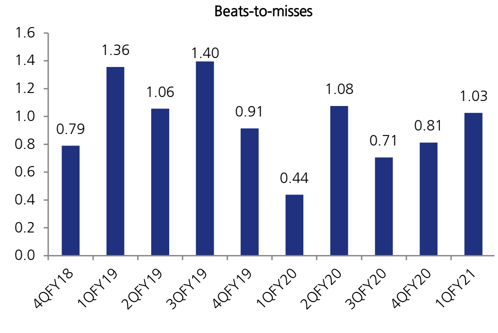
Our estimates build in FY21/FY22 NIFTY EPS of INR439/619 (-7%/+41% YoY). The risk-reward is not favorable at 20.4x NTM PE given the uncertainty on post Covid-19 recovery and we would remain cautious and would recommend trim at every rise.

Exhibit A. 1QFY21 results snapshot

	No. of	Revenue growth		EBITDA growth		PAT growth		EBITDAM Expansion		PATM Expansion	
Sector	comps.	Expected	Actual	Expected	Actual	Expected	Actual	Expected	Actual	Expected	Actual
Airlines	1	(85.0%)	(91.9%)	(167.0%)	(163.8%)	(261.1%)	(336.4%)	(14,669)	(23,725)	(14,999)	(38,373)
Auto +	5	(61.3%)	(56.4%)	(100.1%)	(79.2%)	(999.0%)	(845.0%)	(857)	(447)	(1,950)	(1,470)
Building Mat	2	(44.4%)	(30.8%)	(81.7%)	(52.2%)	(147.9%)	(89.7%)	(828)	(381)	(970)	(443)
Business Services	1	7.4%	(9.2%)	11.1%	6.1%	21.7%	(9.0%)	6	31	20	0
Cement	4	(31.8%)	(31.6%)	(37.4%)	(27.0%)	(42.1%)	(23.0%)	(200)	165	(178)	148
Chemicals	3	(3.1%)	(3.3%)	11.2%	28.9%	50.6%	91.7%	245	557	228	405
Consumer	13	(30.4%)	(19.8%)	(38.7%)	(31.1%)	(36.9%)	(30.2%)	(294)	(344)	(151)	(207)
Industrials	5	(27.9%)	(41.0%)	(82.5%)	(80.5%)	(97.7%)	(96.0%)	(965)	(853)	(716)	(689)
Infra	1	(17.8%)	(28.3%)	(34.3%)	(47.2%)	(69.5%)	(95.1%)	(209)	(273)	(309)	(457)
IT	12	3.5%	2.3%	5.7%	14.1%	(2.1%)	(1.2%)	49	258	(92)	(60)
Metals	3	(35.7%)	(28.2%)	(50.3%)	(38.1%)	(97.0%)	(68.2%)	(549)	(330)	(743)	(433)
Midcaps	5	(43.3%)	(43.2%)	(64.5%)	(45.5%)	(75.3%)	(48.5%)	(466)	(51)	(420)	(70)
Realty	2	(68.5%)	(79.3%)	(73.2%)	(75.7%)	(111.4%)	(105.1%)	(651)	741	(3,165)	(2,890)
Oil&Gas	2	(41.2%)	(47.8%)	(11.7%)	(24.5%)	(20.3%)	(25.8%)	515	458	169	200
Pharma	6	(14.1%)	0.6%	(32.4%)	12.5%	(52.6%)	6.6%	(499)	277	(645)	87
NBFC*	6	6.5%	5.5%	4.2%	3.9%	(15.4%)	(10.8%)	(216)	(157)	(1,099)	(829)
Pvt. Banks	7	14.7%	18.7%	25.7%	13.5%	35.4%	2.4%	814	(368)	647	(493)
SOE Banks	1	(3.6%)	16.1%	(6.4%)	24.7%	38.6%	81.2%	(168)	427	441	564
Financials	14	7.4%	15.8%	13.6%	14.4%	22.0%	7.6%	457	(95)	407	(213)
Textiles	1	(47.2%)	(45.8%)	(71.2%)	(61.8%)	(112.0%)	(91.8%)	(1,031)	(669)	(1,158)	(801)
Utilities	1	(14.4%)	(25.2%)	(8.3%)	(7.9%)	(8.3%)	(22.1%)	238	775	72	42
Total	**81**	**(29.9%)**	**(30.5%)**	**(14.0%)**	**(11.0%)**	**(25.4%)**	**(25.9%)**	**474**	**586**	**62**	**64**
Ex-Fin	67	(33.7%)	(35.2%)	(28.5%)	(24.4%)	(44.3%)	(39.2%)	116	250	(122)	(48)
Ex-Corp Banks	78	(31.6%)	(33.0%)	(19.5%)	(16.7%)	(33.0%)	(31.5%)	323	445	(20)	20
Ex-Metals	78	(29.6%)	(30.6%)	(11.9%)	(9.4%)	(22.6%)	(24.3%)	521	631	97	89
Fin	14	7.4%	15.8%	13.6%	14.4%	22.0%	7.6%	457	(95)	407	(213)
Ex-Oil	79	(22.8%)	(19.7%)	(14.5%)	(7.8%)	(26.6%)	(25.9%)	296	406	(62)	(99)
Ex-Fin Ex-Oil	65	(28.1%)	(25.9%)	(35.4%)	(24.4%)	(52.9%)	(44.1%)	(189)	39	(335)	(239)

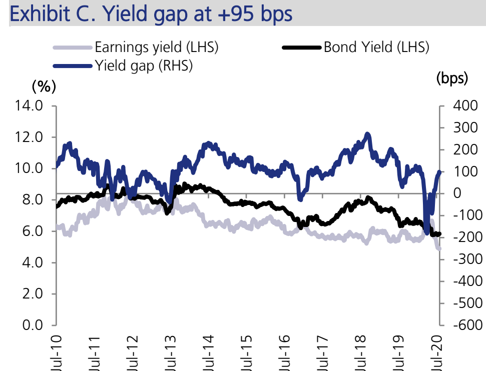
Source: JM Financial

Exhibit B. Quarterly trend of beats-to-misses ratio



Source: JM Financial

Exhibit C. Yield gap at +95 bps



Source: Bloomberg, JM Financial

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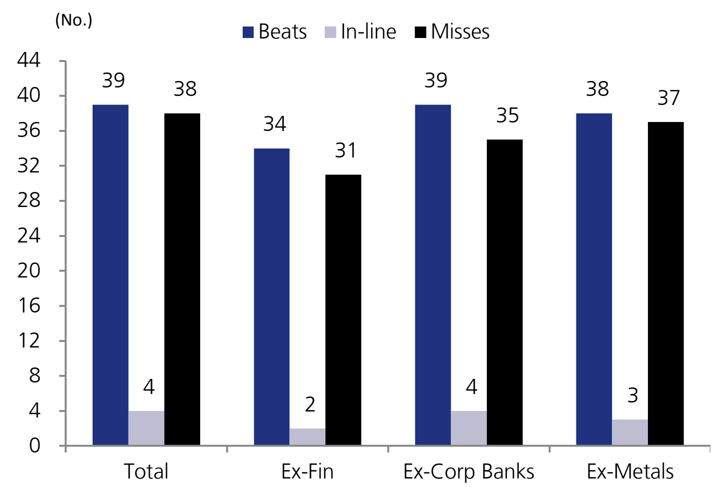
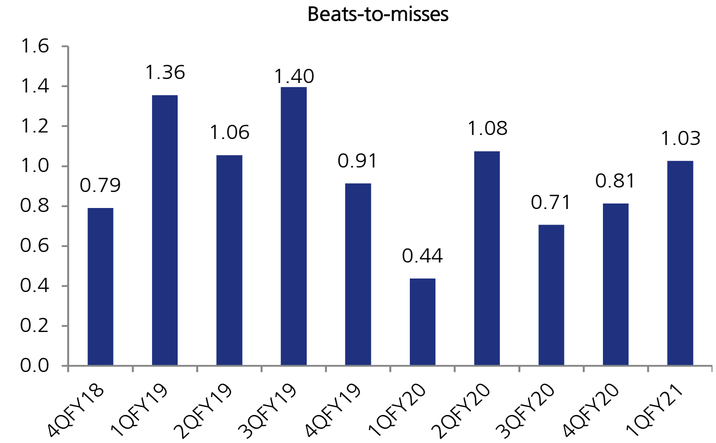
Exhibit 1. 1QFY21: JM universe beats-to-misses



Source: JM Financial

Exhibit 2.Quarterly trend: JM universe beats-to-misses

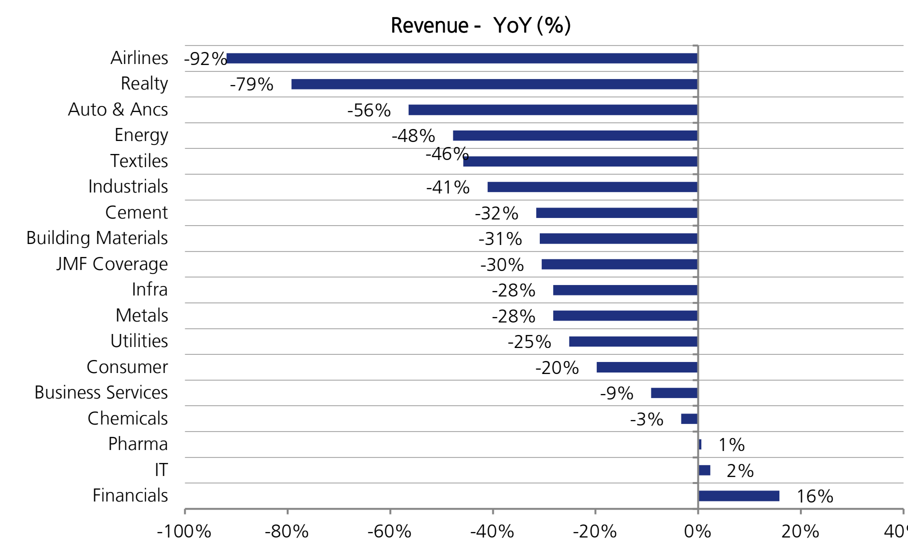


Source: JM Financial

BTM ratio has improved sequentially and at 1.03x was up from 0.75x of past two quarters and 0.9x over the past six quarters. Cement, IT, Mid-caps, Pharma led in BTM, while Auto, Industrials, Infra, Financials led to misses during the quarter.

- JM coverage: For the companies under our coverage, top-line declined by 30% YoY, in-line with our muted expectations. Revenue decline was highest in auto and auto ancs, building materials and industrials, while financials, IT, pharma and chemicals were able to contain de-growth in revenues during the quarter.

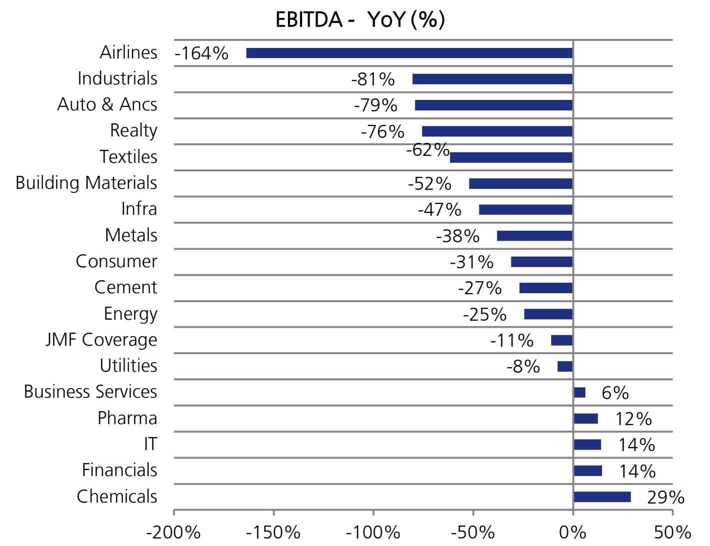
Exhibit 3. 1QFY21: Sector-wise revenue growth



Source: JM Financial

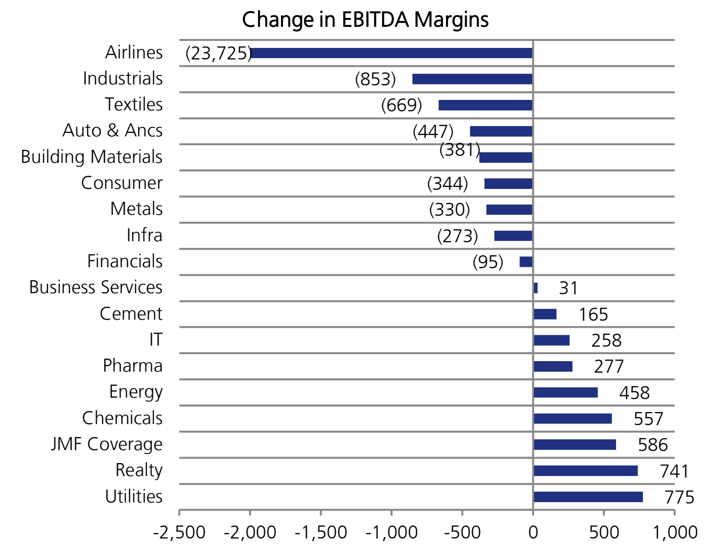
- Margin trend: In 1QFY21, EBITDA margin expanded by 586bps (JMFe: 474bps), higher than our expectations. Sectors across Utilities, realty, chemicals, energy, pharma, IT, cement reported margin expansion, while airlines, industrials, automobiles, building materials, consumer, metals had margin contraction.

Exhibit 4.1QFY21: JM universe sector-wise EBITDA growth



Source: JM Financial

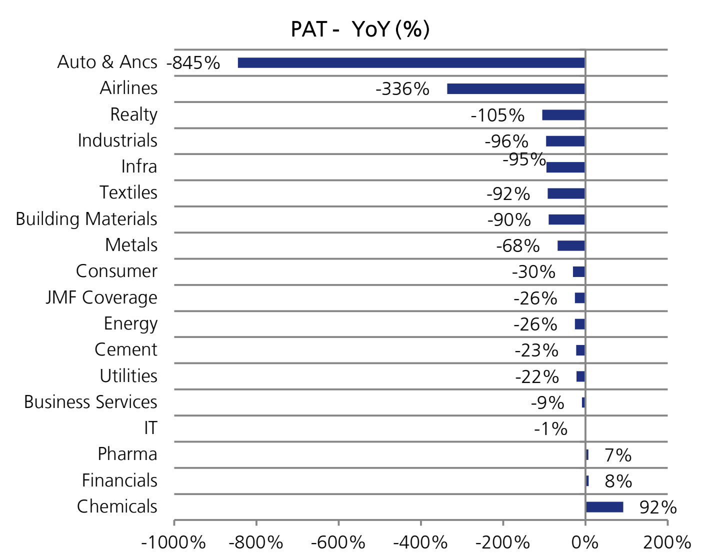
Exhibit 5.1QFY21: JM universe sector-wise change in EBITDAM



Source: JM Financial

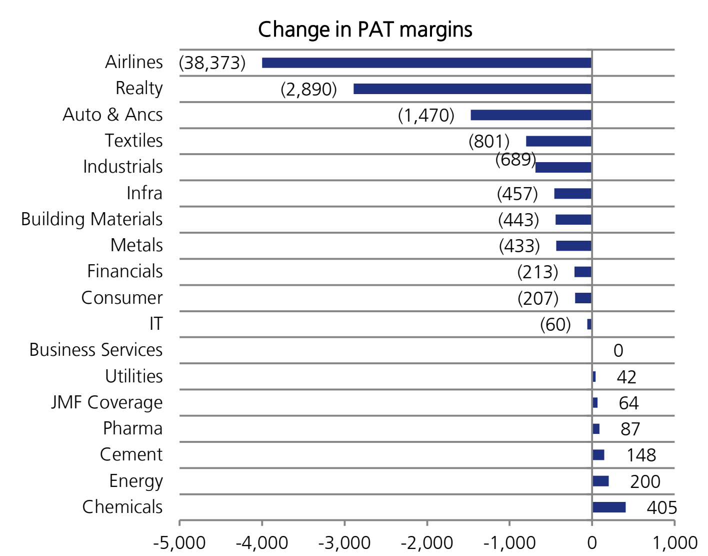
- **Earnings growth:** PAT de-growth at 26% YoY in 1QFY21 was in-line with expectations (JMFe: -25%) and barring Chemicals, financials (Banks), pharma and IT, most of the sectors reported PAT decline during the quarter, impacted by Covid-19 led lock-downs. Airlines, automobiles, realty, industrials & infra, metals led the decline in PAT during the quarter.

Exhibit 6. 1QFY21: JM universe sector-wise PAT growth



Source: JM Financial

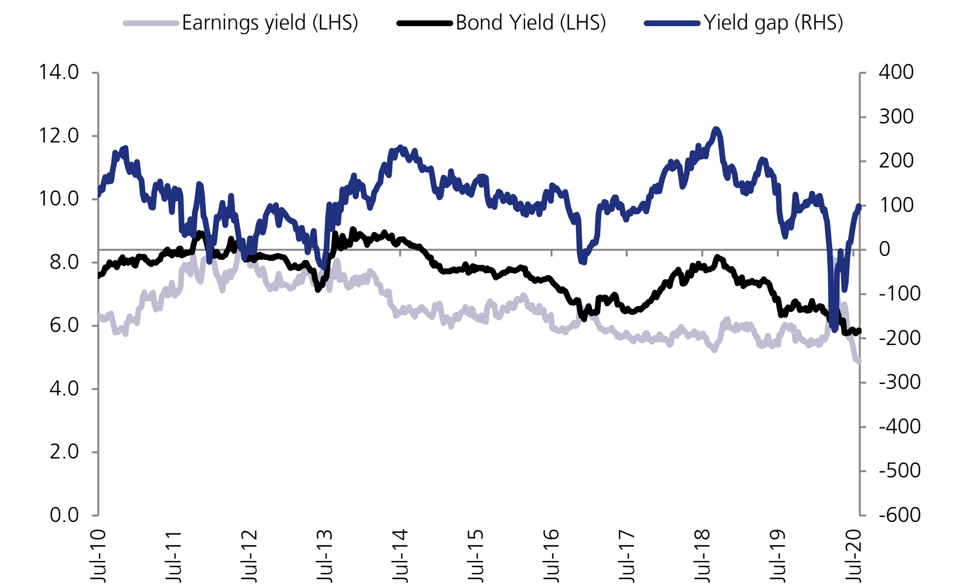
Exhibit 7. 1QFY21: JM universe sector-wise change in PATM



Source: JM Financial

- **Market outlook:** One of the numbers we have been following to track the markets has been the yield gap (Exhibit 8). Based on consensus estimate of the Nifty earnings yield (NTM), the yield gap (10yr bond yield minus earnings yield) is currently around +95bps, while it had mostly been in the negative territory between March-May'20.

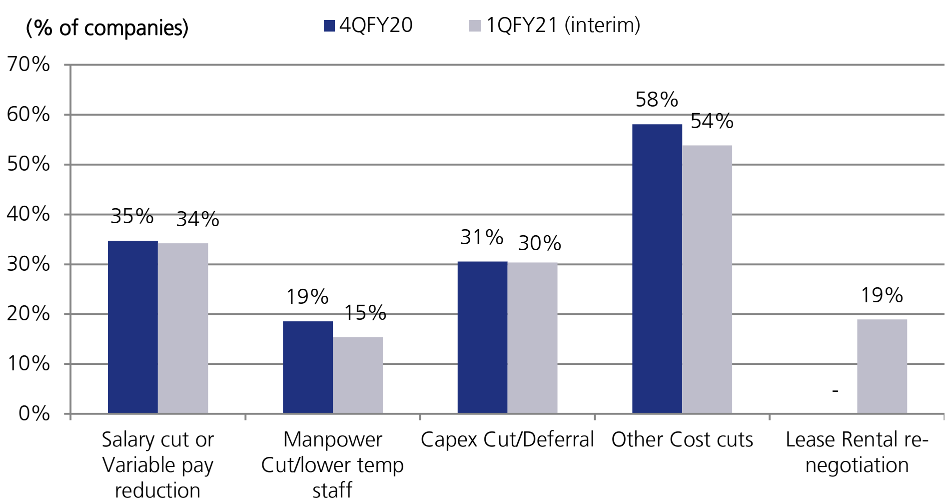
Exhibit 8. Yield gap at +95bps



Source: Bloomberg, JM Financial

Fixed Costs curtailment – a key theme in FY21

Exhibit 9. Cost rationalisation remains a paramount theme in FY21 – Feedback across companies on various cost saving initiatives



Source: Company, JM Financial, Note: Feedback post 4QFY20 (167 companies), and 1QFY21 (81 companies)

Results across companies indicate largely uniform focus on cost rationalization in FY21, and overall the focus has remained unchanged (as compared to 4QFY20 results). We also find that some sectors which have seen normalization of business to a high extent such as staples, chemicals and cement (improved profitability) would be focused more on cost efficiency improvements than a broad-base cost reduction.

- **Salary cut/deferral of variable pay-outs at $1/3^{rd}$ of companies:** Overall, 1/3rd of companies have pursued salary cuts/deferred of variable payments to manage costs. Around 15% of companies have also indicated manpower reductions. It is to be noted that during Apr-Jun'20 period many sectors such as infrastructure, construction and real estate in particular had seen reduction in labour force and hence lower wage cost (due to reverse migration), and this can reverse in the quarters ahead.

- **Capex cut and deferral:** There has not been any major change in commentary around Capex cuts/deferral from the last quarter and almost 1/3rd of companies are looking to defer their capex or cut it till visibility around demand improves.

- **Lease rental re-negotiation:** Almost 1/5th of the companies have indicated undertaking rental lease re-negotiation to lower their costs and this would put near term pressure on rentals.

  Comments across companies (exhibit below) highlight focus on reduction of discretionary expenses such as travel, advertising and promotion and a clear focus to move from a fixed cost structure to variable cost structure.

Exhibit 10. Companies across sectors looking to rationalise costs till demand situation improves

Company	Comments on other cost initiatives (ex of man-power, capex reduction)
ABB India	Permanent reduction in discretionary expenses like trade shows, travel, communication, staff welfare etc.
Bajaj Auto	Going ahead management will continue to reduce fixed cost and is targeting EBITDA levels of 4QFY20 during 2QFY21
Bajaj Finance	Reduction in travel expense, calibrated reduction in technology and to reduce other expenses. Freeze on hiring/branch expansion
Bharat Electronics	Reduction in travel expenses and other various expenses
Ceat Ltd	Reduced other costs by 50% in 1QFY21, expects 15% to be structural
Cement players	Savings related to discretionary spending on travel, advertising and marketing expenses, renegotiation with third party vendors etc.
Cholamandalam Investment	Taken a lot of measures to cut down the other operating expenses, for example, travel, conveyance, petty cash expenses for running the
Crompton Greaves Consumer Electricals	Discretionary spends like A&P pulled back. Crompton had also identified INR 1bn of cost initiatives with onset of Covid-19 in 4QFY20 that
Greenlam	Rentals for some offices and warehouses have been negotiated
Havells	Reduction in office space and renegotiating rental. Discretionary spends like A&P cut
HDFC Life	Discretionary expenses have been deferred.
ICICI Pru Life	Focus on managing discretionary distribution costs like A&P, travel, rewards for distributors, and meeting. In short term the company may be
IndiaMART InterMESH	Significant rental savings. ~50% of the absolute cost savings achieved are sustainable
Indigo	Aims to reduce maintenance and IT costs. Company has also planned INR 60bn liquidity buffer with lease rental renegotiation etc.
Infoedge	Restrained discretionary spends
Just Dial	Curtailed its advertising spends
L&T	Travel and conveyance cost savings of INR 2 bn in 1QFY21
L&T Finance Holdings	Tightened the productivity norms and based on that, some meeting centers, some branches would have reduced
Maruti	In 1QFY21, cuts in advertising & marketing costs. Spends and saving of INR1bn in fixed costs.
Prince Pipes	Savings in business running cost like selling cost, travelling expense
Schaeffler India	Initiated steps in terms of managing expenses very prudently. Substantial identification of areas – travel control, hiring etc. Consolidated
Spandana Sphoorty Financial	Other variable component in the employee side, which is the field executive incentive program, which is linked to performance on collections
Sun Pharma	Lower promotional spend
TeamLease Services	Giving up office spaces. Significant savings in overhead costs, 20-25% of total operating cost savings (core employee expense+overheads)
V-Guard Industries	A&P, Travel cost etc. are lower
Westlife Development	Rentals renegotiated to make it more variable with sales or deferred. A&P and Travel spends have been cut. Store capex postponed. Rentals

Source: Company, JM Financial

APPENDIX I

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SEBI Registration Nos.: Stock Broker - INZ000163434, Research Analyst – INH000000610
Registered Office: 7th Floor, Cnergy, Appasaheb Marathe Marg, Prabhadevi, Mumbai 400 025, India.
Board: +9122 6630 3030 | Fax: +91 22 6630 3488 | Email: jmfinancial.research@jmfl.com | www.jmfl.com
Compliance Officer: Mr. Sunny Shah | Tel: +91 22 6630 3383 | Email: sunny.shah@jmfl.com

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